

# Bankruptcy and Family Law



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It is very common for parties to find themselves in a tight financial situation following separation. Parties often feel like they are 'broke'. However, many people fail to consider what happens when a situation goes beyond simply being 'broke'. In these cases, financial circumstances become so tight that they can sometimes lead to bankruptcy.

## WHAT IS BANKRUPTCY?

Bankruptcy is a legal process which takes place when an individual cannot pay their debts when they are due. When a person is declared bankrupt, their assets are immediately placed the control of a Trustee. This means the bankrupt person does not have any control or possession of their assets and can no longer transfer property.

## TYPES OF DEBTS

In proceedings where a bankrupt is involved, it is necessary to understand the difference between 'secured' and 'unsecured' liabilities.

Secured liabilities are "secured" by a tangible asset such as a house or car – the asset serves as collateral for the debt. Lenders have a right to seize the asset to cover the debt. A mortgage and car loan are the most common examples of secured debt.

With unsecured liabilities, lenders do not have the rights to any collateral for the debt. If you fall behind on your payments, they generally cannot claim your assets for the debt. Credit card debt is the most widely held unsecured liability. As a bankrupt party cannot deal with or transfer their assets, this often leads to frustration for both parties involved in a family law property matter. This is particularly so for the non-bankrupt party as their ability to

negotiate directly with their former partner (the bankrupt party) is extremely limited.

## BANKRUPTCY AND THE FAMILY LAW ACT

Sections 79 and 90SM of the Family Law Act 1975 (Cth), which deal with the adjustment of property following separation, provide for the involvement of the bankruptcy trustee in Court proceedings. It is common for family law proceedings to involve the bankruptcy trustee as a party, and for property settlements to be negotiated (or litigated) between the trustee and the non-bankrupt spouse.

As a result of the above, a person who is bankrupt, or becomes bankrupt, and is a party to family law proceedings must notify the Court at the start of the proceedings or as soon as they become bankrupt. This person cannot deal with property being dealt with by the Trustee, but they can deal will property owned by their non-bankrupt spouse.

If the bankrupt spouse is:

1. The 'Applicant' to the proceedings:
  - a. The proceeding will be 'stayed' (i.e. paused) for 28 days to enable the Trustee to consider whether it wishes to continue the proceeding.
  - b. If the Trustee does not elect to continue the proceeding within the 28 days, the Trustee is considered to have abandoned it. The Respondent may, however, elect to continue the proceeding and rely upon their own court application.
2. The 'Respondent' to the proceedings:

- a. The Trustee will be given the opportunity to join the proceedings; or
- b. The Respondent may elect to join the Trustee to the proceeding.

When making a final Court Order, Family Law Courts are required to take into account the effect of any Order on the ability of creditors to recover their debts. However, the interests of creditors do not take priority over the interest of a non-bankrupt spouse. Therefore, a Court can make a Order to transfer property to a non-bankrupt spouse even if it would result in the Trustee being unable to pay any or all of the bankrupt’s creditors.

However, the Courts have historically found that it would not be just and equitable (that is, ‘fair or reasonable’) for a non-bankrupt spouse to receive a direct or indirect financial benefit from the wrongdoing of the bankrupt spouse. It is therefore frequently a difficult exercise for Courts to balance the legal entitlements of the non-bankrupt spouse and the impact to children on the one hand, and third-party creditors on the other.

It is important to note that once the Court makes a property settlement Order in favour of the non-bankrupt spouse, the Trustee can on very limited grounds apply to set aside the Order. Sometimes spouses may obtain property settlement Orders from the Family Court on a consent basis before the bankruptcy arises. For the Trustee to succeed, the Trustee needs to establish that the Order was obtained by reason of a failure to disclose relevant information (such as the imminent bankruptcy of one of the spouses), fraud, duress or false evidence.

**MY FORMER PARTNER IS ABOUT TO BE DECLARED BANKRUPT - WHAT SHOULD I DO?**



If you become aware that your former partner is about to be (or has recently been) declared bankrupt, this may have a significant impact on your property proceedings and/or settlement. It is important that you obtain legal advice as soon as possible as to your options and how to minimise any impact on you.

Our solicitors can provide you with legal advice about the impact of bankruptcy on your family law matter. Give us a call for a free chat with a solicitor.



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